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No. _____

In the

# Supreme Court of the United States

October Term, 1987

BAUMANN-FURRIE & COMPANY,

*Petitioner,*

vs.

COMMODITY CREDIT CORPORATION, UNITED STATES DEPARTMENT OF AGRICULTURE, et al.,

*Respondents.*

## PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

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## QUESTION PRESENTED

Does 7 CFR §102.6(c), which requires a grain warehouseman licensed under the United States Warehouse Act (7 U.S.C. §241-273) to file with the Secretary of Agriculture prescribed financial statements audited or reviewed by an independent public accountant with the understanding that the warehouseman will be subject to an additional on-site examination and audit by the Secretary, grant the Secretary discretion to perform those examination and audit functions before he accepts the financial statements in compliance with the Warehouse Act?

## LIST OF PARTIES

The parties to the proceedings below were Gary W. Koch as trustee in bankruptcy for Ghent Grain and Feed, Inc., a Minnesota corporation; plaintiff in an action for negligent misrepresentation against petitioner Baumann-Furrie & Company, a partnership.

James Welsh, Kent Welsh, Thomas Welsh, John Doe and Mary Roe were officers, directors and shareholders of Ghent Grain & Feed, Inc. and named by petitioner as third-party defendants below. Gary W. Koch was also named, individually, as a third-party defendant below as was Tri-State Insurance Company of Minnesota. Commodity Credit Corporation, and United States Department of Agriculture, were named third-party defendants by petitioner below and are

respondents before this Court and the parties in this proceeding whose judgment is sought to be reviewed. It is believed that the other named parties have no interest in these proceedings.

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THE UNITED STATES

OCTOBER TERM, 1987

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BAUMANN-FURRIE & COMPANY,

Petitioner,

vs.

COMMODITY CREDIT CORPORATION, UNITED STATES DEPARTMENT OF AGRICULTURE, et al.,

Respondents.

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The Petitioner, Baumann-Furrie & Company, respectfully prays that a Writ of Certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Eighth Circuit, entered in the above-entitled proceeding on February 18, 1987.

## OPINIONS BELOW

The Opinion and Judgment of the Court of Appeals for the Eighth Circuit has not been reported and is reprinted in the Appendix hereto at Page A-1, infra.

The Memorandum Decisions of the United States District Court for the District of Minnesota, Third Division (Magnuson, D.J.) have not been reported and are reprinted in the Appendix hereto at Page A-22, infra.

## JURISDICTION

Petitioner was named a party Defendant in an action for negligent misrepresentation brought in the Bankruptcy Court for the District of Minnesota, Third Division, under 28 USC §158(a). Petitioner joined the UNITED STATES DEPARTMENT OF AGRICULTURE and COMMODITY CREDIT CORPORATION as Third Party Defendants

therein under 28 U.S.C. 1346(b). On September 25, 1985 the Bankruptcy Court recommended the granting of those third party defendants' Motion to Dismiss because of lack of subject matter jurisdiction. The District Court granted that Motion under the discretionary function exception of 28 U.S.C. 2680(a) and other relief by orders dated March 21, 1986 and May 7, 1986, respectively.

On Petitioner's appeal, the Eighth Circuit, under the jurisdiction granted in 28 U.S.C. §158(d), affirmed the order of the District Court. No petition for re-hearing was sought.

Jurisdiction of this Court to review the Judgment of the Eighth Circuit is invoked under 28 U.S.C. §1254(1).

## STATUTE INVOLVED

28 U.S.C. §2680 exceptions:

The provisions of this chapter and section 1346(b) of this title (Federal Tort Claims Act) shall not apply to:

(a) Any claim based upon an act or ommission of an employee of the government exercising due care, in the execution of a statute or regulation, whether or not such statute or regulation be valid, or based upon the exercise or performance or the failure to exercise or perform a discretionary function or duty on the part of the Federal agency or an employee of the government, whether or not the discretion involved be abused.

REGULATION INVOLVED

7 C.F.R. §102.6 (a), (b) and (c), financial requirements:

(a) Each warehouseman conducting a warehouse licensed, or for which application for license has been made under the regulations in this part, shall maintain complete, accurate and current financial records.

(b) Each warehouseman conducting a warehouse for which application for license is made shall provide with this application and each warehouseman licensed under these regulations annually, or more frequently if required, shall furnish the Secretary financial statements from the records required in paragraph (a) of this section prepared according to generally accepted accounting principles. Such statements shall include but not limited to (1)

balance sheet, (2) statement of income (profit and loss), (3) statement of retained earnings, and (4) statement of changes in financial position. The chief executive officer of the warehouseman shall certify under penalties of perjury that the statements as prepared accurately reflect the financial condition of the warehouseman as of the date named and fairly represent the results of operations for the period named.

(c) Each warehouseman conducting a warehouse licensed under these regulations shall have the financial statements required in paragraph (b) audited by an independent certified public accountant. Alternatively, financial statements audited or reviewed by an independent public account will be accepted with the understanding that the warehouseman will be subject to an additional on-site examination by the Secretary and to an audit by the Secretary. Audits and reviews by independent certified public accounts and independent public accounts specified in this section shall be made in accordance with the standards established by the American Institute of Certified Public Accountants. The accountants certification, assurances, opinion, comments, and notes on such statements, if any, shall be furnished along with the statements. Licensees who cannot immediately meet these requirements may apply to the Secretary for a temporary waiver

> of this provision. The Secretary may grant such waiver for a temporary period not to exceed 180 days if the licensee can furnish evidence of good and substantial reasons therefore.

(Underlining supplied).

STATEMENT OF CASE

Ghent Grain and Feed, Co., Inc. (hereinafter Ghent) is a corporation organized and existing under the laws of the State of Minnesota and was engaged in business as a grain warehouseman, buying and storing oats, corn, wheat and soybeans for and from farmer-producers in its geographical area. It was licensed under the United States Warehouse Act (7 U.S.C. 241-273) and was an approved depository for grain storage by the Commodity Credit Corporation. James Welsh, Kent Welsh and Thomas Welsh are its sole officers, directors and shareholders. Tri-State Insurance Company of

Minnesota acted as the warehouseman's bondsman under the provisions of 7 C.F.R. §102.14 for the relevant period and Gary W. Koch is its bankruptcy trustee.

Petitioner, a Minnesota Partnership, is a licensed independant public accounting firm that provided various accounting services to Ghent for over a ten (10) year period terminating in March of 1983. These services included the preparation of corporate income tax returns, unaudited and "review" financial statements[1]

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[1] The Codification of Statements on Standards for Accounting and Review Services, No.'s 1 to 5, Commerce Clearing House, Inc. (1983) AR §100.04 at Page 7, provides:

> A review of financial statements. Performing inquiry and analytical procedures that provide the accountant with a reasonable basis for expressing limited assurance that there are no material modifications that should be made to the statements in order for them to be in conformity with generally accepted accounting principles or,

and TW-51 "financial statement" reports required by, and filed with, the United

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if applicable, with other comprehensive basis of accounting. (The accountant might consider it necessary to compile the financial statements, or to perform other accounting services to enable him to perform a review. See paragraph 28) The objective of a review differs significantly from the objective of a compilation. The inquiry and analytical procedures performed in a review should provide the accountant with a reasonable basis for expressing limited assurance that there are no material modifications that should be made to the financial statements. No expression of assurance is contemplated in a compilation. The objective of a review also differs significantly from the objective of an examination of financial statements in accordance with generally accepted auditing standards. The objective of an audit is to provide a reasonable basis for expressing an opinion regarding the financial statements taken as a whole. A review does not provide a basis for the expression of such an opinion because a review does not contemplate a study and evaluation of internal accounting control, tests of accounting records and of responses to inquiries by obtaining and corraborating evidential matter

States Department of Agriculture (hereinafter USDA) and the Commodity Credit Corporation (hereinafter CCC) in connection with its warehouse license and depository approval prior to July 1, 1982.

Petitioner prepared a review financial statement for Ghent for the fiscal year ending June 30, 1982. This review statement was subsequently filed with the U.S.D.A. pursuant to 7 C.F.R. §102.6(c) on November 17, 1982. It represented that Ghent owned (as opposed to stored) certain grain inventories indicated

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through inspection, observation or confirmation, and certain other procedures ordinarily performed during an audit. A review may bring to the accountant's attention significant matters affecting the financial statements, but it does not provide assurance that the accountant will become aware of all significant matters that would be disclosed in an audit.

therein as located off-site at what were designated as the "Cargill" and "Continental" terminal warehouses.

On January 3, 1983, USDA and CCC, through its agent, Agricultural Marketing Service, operating under the provisions 7 U.S.C. §267 of the United States Warehouse Act and 7 C.F.R. §102.39, conducted an inspection and physical measurement of the grain, warehouse receipts and daily position records of the storage facilities at Ghent.[2] That examination

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[2] 7 U.S.C. § 267 provides:

> That the Secretary of Agriculture is authorized through officials, employees or agents of the Department of Agriculture designated by him to examine all books, records, papers and accounts of warehouses licensed under this act and of the warehouseman conducting such warehouses relating thereto.

> §102.39 Inspections: examination of warehouse.

> Each warehouseman shall permit any

was primarily to determine the sufficiency of grain on-site to cover the warehouseman's obligations evidenced by the warehouse receipts issued and did not seek to verify the existence of the inventory stored at the "Cargill" and "Continental" warehouses.

On March 9, 1983, during the course of a subsequent accounting examination, the Petitioner determined that the officers, directors and shareholders of

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> officer or agent of the Department, authorized by the Secretary, or his designated representative, for the purpose, to enter and inspect or examine on any business day during the usual hours of business, any warehouse for the conduct of which such warehouseman holds a license, the office thereof, the books, records, papers, and accounts relating thereto, and the contents thereof and such warehouseman shall furnish such officer or agent the assistance necessary to enable him to make any inspection or examination under this section.

Ghent had misrepresented to it the existence of those off-site inventories. The effect of this was to render Ghent insolvent and in violation of both the USDA licensing and CCC net worth requirements.

Upon receiving notice of this change in financial condition, the USDA conducted subsequent financial examinations of the elevator in August and September of 1983, resulting in the suspension of Ghent's warehouse license and its removal from the approved list of storage facilities by the CCC. Ghent declared voluntary bankruptcy on or about November 3, 1983. The creditor claims filed exceeded its assets by over One Million Dollars.

On August 31, 1984, Respondent Gary W. Koch, trustee in bankruptcy for Ghent, commenced an action in the Federal District Court against petitioner for

negligent misrepresentation of Ghent's financial condition as represented in the respective review financial statements for six month periods commencing December 31, 1980 through June 30, 1982. The Trustee alleged that the petitioner, in the exercise of due care, should have known that the represented inventories at the Cargill and Continental warehouses were fictitious and should not have included that representation in Ghent's financial statements.[3]

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[3] On February 19, 1985, a comparable action was commenced in the District Court for Lyon County, Minnesota by 83 farmer-depositors against Petitioner. The plaintiffs were claimants in the bankruptcy proceeding. That matter was initially removed to the Federal District Court for the District of Minnesota, but later remanded to Lyon County. That action was tried, in part, during January of 1987, resulting in a Judgment pursuant to stipulation between the plaintiffs and petitioner whereby liability was admitted but recovery limited to the

Petitioner defended on the grounds that the existence of those outside inventories were specifically represented to it, in writing, by Ghent's officers, directors and shareholders and that it was not required, within the scope of its review engagement, to verify the existence of those inventories as it would have been within audit standards.[4]

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proceeds of the insurance policy carried by Petitioner. A second action is now in process to determine whether or not Plaintiff will recover any funds pursuant to their judgment.

That judgment has rendered the abstention question presented to the Eighth Circuit moot.

[4] The auditing standards of the American Institute of Certified Public Accountants, specifically referred to in the cited regulation, require direct confirmation of inventories kept in public warehouses. See S.A.S. No. 43, A.I.C.P.A., Omnibus Statement of Auditing Standards, AU §1010.03 (August 1982).

Petitioner contended that the Secretary of Agriculture is specifically charged to conduct an audit of Ghent's review financial statements under the provisions of 7 CFR 102.6(c) and amended its third party complaint to include such claims against USDA and CCC. The government moved to dismiss on various grounds, including the cited discretionary function exemption. The Bankruptcy Court recommended dismissal and the District Court, in its order of March 21, granted the Motion, citing United States v. S.A. Empresa de Viacao Aerea Rio Grandense (Varig Airlines), 467 U.S. 797, 104 S. Ct. 2755 (1984) as authority. The Eighth Circuit, by its Order dated and filed February 18, 1987, affirmed the District Court's ruling, looking again to Varig Airlines as controlling.

United States Warehouse Act (Title 7, USC 241-273) was enacted by Congress in 1916 to improve the country's agricultural warehousing industry. Grain Elevator Task Force Report to the Secretary of Agriculture, USDA, August 18, 1981, Page 1. Its primary objectives were to (1) protect producers and others who store their property in public warehouses; (2) assure the integrity of warehouse receipts as documents to title to be used as collateral for loans, and to facilitate trading in interstate commerce of agricultural commodities; and (3) set and maintain a standard for sound warehouse operations. 46 FR 59930, December 7, 1981. To effect these ends, The Secretary of Agriculture conducted those examinations provided for in 7 U.S.C. §267 and 7 CFR §102.39 (See Footnote 3).

The warehouseman's regulated services were to store grain for farmers, the CCC or other depositors. He would also provide a market by buying and selling grain for cash. The income from these services was the storage charges received from the depositors and whatever profit could be made from the resale of the elevator grain purchased. The basic legal relationship between the warehouseman and the storage customer was that of Bailor-Bailee. The depositor maintained ownership of the grain evidenced by the warehouse receipt issued to him. This relationship began to change with the advent of the Delayed Price Agreement.[5]

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[5] Delayed price and deferred payment contracts are defined on Page 41 of the Task force Report as:

"The usual marketing relationships have been complicated by another kind of transaction conmmonly known as price-later or deferred pricing

There, the farmer became an unsecured creditor of the warehouse when his commodity was delivered and sold to the warehouse, not for cash, but for payment to be completed at some future time. Grain Elevator Task Force Report at Page 4.

The on-site examinations conducted by the Secretary prior to July 1, 1982, were reflective of the bailor-bailee

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or delayed price grain. Such a transaction may be described as a sales contract that constitutes a bonfied sale and change of ownership from the seller to the buyer, but which permits the seller to fix the price of the grain at a later date as a pre-agreed formula for determining such price. The seller may continue to have some control of the pricing of his grain, but he has no physical claim. Generally, no advance payment is made to the seller. The buyer has only a grain payable position with the seller. The seller has only money receivable position, a consumer creditor status."

relationship; to determine that the commodities for which the warehousemen had issued warehouse receipts were actually available in sufficient quantity and quality to cover those obligations.

In 1981, in the wake of some 177 grain elevator bankruptcies, the Secretary of Agriculture appointed a USDA Task Force, "to review current grain warehouse laws and regulations."

> I have asked the Task Force to tell me what needs to be done to safeguard the interests of all farmers, consumers, and those with financial stake--in the event of elevator bankruptcies.

Statement by John R. Block, Secretary of Agriculture, before the Court's Subcommittee of the Senate Judiciary Committee, April 6, 1981. What the Task Force told the Secretary was that a basic change in the legal-business relationship between the warehouseman and his customer had

taken place. It was no longer primarily that of a bailor-bailee, but to a large extent had become debtor-unsecured creditor:

> In the last several years, the risks for producers in dealing with grain warehouses have shifted from the storage to the marketing operation. Almost all elevators which store grain, will buy grain. The use of delayed price and deferred payment contracts has lessened the amounts of grain stored and increased grain payable accounts contributing to this high loss risk. The business of storing and marketing cannot be segregated. These situations create continuous, dual and, at times, uncertain obligations. USDA has considered for some time regulations which would offer some protection to users of Federally licensed warehouses to deposit their grain for other than storage purposes...They are aimed at extending the use of good business practices. When these regulations are in effect, a measure of protection is afforded to users of Federally licensed warehouses who deposit their grain for marketing as well as those who deposit for storage.

(At pages 18 and 19 of the Grain Task Force Report).

This debtor-creditor relationship arose through a series of transactions. The farmer-producer would raise the grain and sell it to the warehouseman under a delayed price contract at a price to be set later by the farmer. In this manner, the farmer did not have to store the grain in anticipation of a rise in market prices, but could clear his storage facilities and still benefit by any upward movement in its price.

The warehouseman would take title to the grain and most often sell it immediately to a grain terminal (Cargill; Continental) at the day's cash price. The terminal would remit that amount to the warehouseman upon delivery of the grain, but the warehouseman did not pay the farmer. He would state on account payable to the farmer and use the money in the operation of his business. If

the operation of his business. If there was subsequent rise in the market price, the warehouseman could sustain a loss when the farmer priced the grain. If there was a reduction in price, he could realize a gain. Unless the warehouseman hedged the transaction, or stored the grain for sale until the time the grain was priced by the farmer, the warehouseman could be at substantial risk of loss. (Ghent used the farmers' grain proceeds to repay its bank loans and commodity losses.)

In order to deal with this problem, the Task Force recommended that audited financial statements from independent certified public acountants be required of licensed warehouses. (Task Force Report, Page ii). In this way the USDA would know that the warehouseman had

verified assets on hand sufficient to cover the amount of accounts payable outstanding, as well as adequate grain to meet its storage obligations.

It urged:

> Protection already in effect for storage customers must be maintained, but the bond for marketing (where the greater risk to producers is) should be more than that for storage. Bonds for marketing are extremely difficult to obtain and are costly ($10.00 per 10,000). The "slack" must be taken up in added administrative and supervisory requirements such as the frequency of examinations and extended scope of such examinations which may include additional financial reporting requirements.

(Grain Task Force Report, Pages 20 and 21).

This recommendation produced a regulation that would require that each warehouseman "shall provide the Secretary with an annual financial statement which has been audited by a Certified Public

Accountant in accordance with generally accepted accounting standards and such other interim financial statements or information as the Secretary deems necessary." 46 FR 59930, December 7, 1981.

The proposal met with a number of objections, among them (1) the limitation of auditing by Certified Public Accountants and (2) higher costs for warehousemen due to auditing procedures. 47 FR 23910, June 1, 1982.

In adopting the present regulation, the USDA concluded:

> The limitation of an audit using Certified Public Accountants exclusively has been revised. . . Statements may now be "reviewed" or "audited" by an independent public accountant as well as an audit by a certified public accountant, if the warehouseman subjects himself to an additional on-site examination by the secretary and to an audit by the Secretary.

47 CFR 23910, June 1, 1982 (underlining supplied).

No additional on-site examination or audit was conducted by the USDA or CCC of the financial statements or books and records of Ghent after July 1, 1982, the effective date of regulation.

Petitioner has claimed throughout these proceedings that the language of the regulation requiring the second examination and audit is operational, not discretionary. Once in place, that requirement brings the Secretary of Agriculture within the "Good Samaritan" doctrine under both Federal and Minnesota law. Block v. Neal, 646 F.2d 1178 (6th Circuit, 1981); Isler v. Burman, 232 N.W.2d 818 (1975)."[6]

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6 "...One who undertakes an act, even though gratutiously, is required to act carefully and with the exercise of due care and will be liable for the injuries proximately caused by failure to use such care." Block v. Neal, cited supra, p. 1092.

## REASONS FOR GRANTING THE WRIT

### I

### THE TERM "WILL BE SUBJECT TO" IS NOT DISCRETIONARY IN MEANING UNDER THE REGULATION IN THE ABSENCE OF LEGAL PRECEDENT OR LEGISLATIVE INTENT.

The sole basis for the Eighth Circuit's ruling is its holding that the words "will be subject to" are in and of themselves words of discretion and do not require the Secretary of Agriculture to audit review financial statements submitted in accordance with 7 CFR 102.6(c). Only by so holding is that Court able to analogize those requirements to the "spot check" language of United States v. Varig Airlines, cited supra, in order to bring this decision within that.

Such construction, in light of the "plain reading" of the regulation, the absence of supporting legislative

history, legal precedent or any record of such intent, is not warranted. The comparable language found in Sections 14, 17 and 18 of the United States Warehouse Act (7 USC §255, 259 and 260), requiring agricultural products be stored, transferred and receipted "subject to" the Act, its rules and regulations, presents a fundamental inconsistency of interpretation within the same body of law.

The clear meaning of this phrase is to allow acceptance of "review" financial statements for licensing purposes "conditioned upon" the performance of a second examination and audit by the Secretary. The audit function is the verification process adopted to protect the unsecured creditors of the warehouseman correspondent to the

Secretary's physical "measure-up" of the stored grain used to protect his storage customers.

Had discretion been intended, it would have been a small matter to indicate. The change of the word "will" as used in "will be subject to" to "may" could suffice. Instead, the only indication given by the Secretary to that construction is that:

> Statements may now be "reviewed" or "audited" by an independent public accountant, as well as an audit by a certified public accountant, if the warehouseman subjects himself to an additional onsite examination by the Secretary and to an audit by the Secretary.

47 FR 23910, dated June 1, 1982 (underlining supplied).

"Subject to" is a term of qualification. Renner v. Chrisman, 80 S.D. 532, 127 N.W.2d 717 (1964). It has been variously defined in the case law as

meaning "liable", "subordinate to", "subservient to", "inferior", "obedient to", "limited by", "charged with", "conditioned upon", "controlled by", "bound or obligated in law or equity", "regulated by", "responsible" and "answerable". Chandler v. Hjelle, 126 N.W.2d 141, 147 (N.D. 1964); Renner v. Chrisman, cited supra at page 721; Interway, Inc. v. Alagna, 407 N.E.2d 615, 619, 41 Ill. Decs. 117, 121, 85 Ill. App. 3rd 1094 (1980); Homan v. Employer's Insurance Corp., 345 Mo. 650, 136 S.W.2d 289 (1939); State of Hawaii v. Willburn, 49 Ha. 651, 426 P.2d 626 (1967). It is not a discretionary term.

More in point, the Eighth Circuit's ruling here is contrary to legislative intent. The comment to the proposed regulation makes this clear:

> Consequently, there are risks for producers who sell deposited grain as well as producers who store such grain. It therefore becomes consistent with the objectives of the Act to define the various marketing transactions for licensed grain warehousemen which are the regulatory concerns of the Secretary under the terms of the Act.

46 FR 30620, June 9, 1981.

In order to provide this necessary protection to the grain sellers, the Grain Task Force report called for the preparation and filing of audited financial statements prepared by a certified public accountant. A review financial statement is substantially less than an audit and does not provide such protection. (See footnote 1) It is essentially a compilation of financial information upon which the accountant performs certain inquiry and analytical procedures. These procedures consist of a determination of the entity's

accounting principals and practices, its procedures for recording, the comparison of financial statements with statements of comparable prior periods or for anticipated results (budgets or forecasts) and the application of certain ratios. Codification of Statements and Standards for Accounting and Review Services, Numbers 1 to 5, § 100.27, Commerce Clearing House, Inc., 1983, at page 14.

A review does not require a physical counting or examination of inventory, confirmation of accounts receivable and payable, or the other evidentiary procedures commonly made part of the audit. Its cost is substantially less, perhaps as much as one-half.

Had the Secretary determined that he would accept review statements in satis-

faction of the financial requirements of 7 CFR 102.6(c), without more, it is clearly within his discretion to do so. But he conditioned that acceptance in order to afford the selling producer the same relative protection historically given by him to the storage producer, a verification of the existence of the assets necessary to meet the warehouseman's obligations.

The Secretary knows that the licensed warehouseman most in need of regulation would not provide an audit. Its cost would drain otherwise needed funds and the verification of financial difficulties the warehouseman might otherwise seek to conceal would jeopardize his license. The cost of the additional inspection and audit by the Secretary would be passed on to the

warehouseman and consumer under the provisions of 7 U.S.C. §251.

Both the District and Appellate Courts looked exclusively to United States v. Varig Airlines to justify their ruling against Petitioner. Although alike in the initial reporting requirements, the Federal Aviation Act (Varig) and United States Warehouse Act are distinguished by the respective duties required of the government in their administration.

Under Varig, contention was made the the FAA had been negligent in failing to inspect certain elements of aircraft design before certification. This circumstance, it was claimed, led to destruction of the aircraft and loss of substantial life. Called into question was the FAA's "spot check" system of

compliance review and its application in the FAA's failure to determine the existence of inflammable materials and negligent design before certification.

There, it was the government's contention that the basic responsibility for satisfying its safety standards rested with the manufacturer of the aircraft; that the government's function was only to police the manufacturer in its compliance with its regulations. The monitoring mechanism specifically called for a "spot check" program wherein the FAA consciously did not inspect all parts of the aircraft certified to be airworthy, and varied in degree what examination it did conduct upon the experience of the manufacturer.

In denying jurisdiction, the Varig Court noted the substantial and specific

detail of that program provided in the FAA handbooks and manuals developed for use in the compliance procedures. These specifically set forth the discretion given to the F.A.A. examiner and allowed the Court to conclude that the "spot check" program and its application to be well within the Secretary's intention.

The USDA program is comparable only in that it requires the warehousemen to provide books, records and financial statements as a condition of its license. It varies dramatically, however, in the "monitoring" procedure. Unlike the F.A.A. inspectors, the USDA examiner goes physically onto the warehouse premises, personally examines and audits the daily position records and documents kept there to determine the on-site inventory status, reviews the warehouse receipts

issued to reflect the grain stored and then physically samples and "measures up" the grain on hand to determine whether it covers the warehouse receipts outstanding. If a deficiency is determined, the warehouseman is placed on notice and given a specified time to correct without suspension and/or eventual cancellation of its license.[7] The warehouseman filed TW-51 financial statement report forms with the Secretary

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[7] A recent decision, Alabama Power Company v. Costle, 636 F.2d 323 (D.C. Cir. 1980), dealt with the requirements of the Clean Air Act (42 USC §7475) to determine which pollutants were "subject to" the best available control technology for each pollutant "subject to" regulation under this chapter...." The suggestion that "subject to" as used in the statute might be discretionary was not considered nor requested to be considered. The ruling there was that the pollutant came within the statute because it was made expressly "subject to."

to establish that he had met the minimum net worth requirements under the law ($25,000.00) and for purposes of setting his bond (20 cents per bushel for the first 1,000,000 bushels).

The government has provided no regulation, legislative history, handbook or manual in support of its contention that the second examination and audit prescribed by 7 CFR §102.6(c) is discretionary. To the contrary, its handbooks and manuals detail audit and inspection procedures of storage verification. The requirement that the Secretary must examine and audit review financial statements is clearly consistent with his procedures to examine and audit stored grain and, as was indicated in the Task Force Report, is the only real protection given selling

producers who market their grain under delayed pricing agreements.

## II.

### THE DECISION THAT THE TERM "WILL BE SUBJECT TO" IS A GRANT OF DISCRETION RAISES IMPORTANT QUESTIONS FOR THIS COURT.

The ruling here is contrary to the Secretary's clear intent, unsupported by legal precedent or legislative history, and flies in the face of the plain and accepted meaning of the term "subject to." It serves only to protect the administrators of the law, not those for whom that protection was intended.

If the Eighth Circuit is correct on the basis of the record before it, what then isn't discretionary? The clear effect of the decision is an arbitrary revisiting of governmental immunity.

The potential impact of the decision is widespread. A LEXIS search indicates

that the word "subject" appears 10,518 times in the United States Code, 118,060 times in the Federal Register and Code of Federal Regulations (after July 1, 1980). The word "will" used within five words of "subject" appears 107 times in the Code and 15,010 times in the Federal Register and C.F.R. Its use in conveyances, contracts and other documents, rules, ordinances and regulations is no doubt countless.

The immediate impact is on the agricultural community. As of October 1, 1980 there were 228 cotton warehouses, 1808 grain elevators and 74 warehouses storing other agricultural products licensed under the U.S. Warehouse Act. These represented 54% of the commercial cotton storage and 43% of commercial grain storage facilities in the country (Grain and Task Force Report, page 1).

The bankruptcy of the elevator at Ghent, with only a 243,000 bushel capacity and an approximate $6,000,000 dollar volume per year, left over a million dollar financial impact on the small and otherwise economically depressed community that it served.

The need for review is twofold. First, some specific definition of discretion is required under the Federal Tort Claims Exemption. As Varig Airlines has been applied here, litigants are without any meaningful precedent. This Court must provide some boundaries whereby the government and counsel can evaluate the claims submitted with more certainty. In an arena of ever-expanding, complex, business-oriented litigation, the administrative claims procedure under the Federal Tort Claims

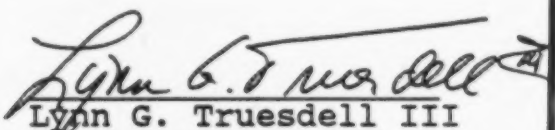
Act will serve no purpose without such guidance.

Second, a substantial portion of the Producers in the agricultural community have been left essentially as they were found, despite repeated calls by the Secretary's Task Force for regulation and protection. Review financial statements do not provide the verification of an audit. There is no suggestion that the equivalent audit procedures conducted by the Secretary as to stored commodities is discretionary. Yet, it has been determined by the appellate court that the marketing function of the warehouseman's business, the function pin-pointed as giving rise to the bankruptcy onslaught, should go effectively unregulated on the single proposition that "subject to" is discretionary language.

## CONCLUSION

The Court should reverse the Eighth Circuit's Opinion for the reasons stated and remand the matter to the District Court for further proceedings. Failing this, the petition for certiorari should be granted.

Respectfully Submitted,

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**APPENDIX**

UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

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No. 86-5205

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In Re: Ghent Grain and Feed, Inc.,

Debtor,

Gary W. Koch, Panel Trustee,

v.

Baumann-Furrie and Company,

Appellant,

v.

James Welsh, Kent Welsh, Thomas Welsh, John Doe and Mary Roe, whose full and true names are unknown,

Commodity Credit Corporation, U.S. Department of Agriculture, Gary R. Koch, trustee,

Appellees,

and Tri-State Insurance Company of Minnesota.

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APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF MINNESOTA

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Submitted: December 11, 1986

Filed: February 18, 1987

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Before McMILLIAN, Circuit Judge, BRIGHT, Senior Circuit Judge, and BOWMAN, Circuit Judge

Baumann-Furrie & Co. appeals from a final order entered in the District Court [the Honorable Paul A. Magnuson, United States District Judge for the District of Minnesota] for the District of Minnesota dismissing with prejudice its third-party complaint against the United States Department of Agriculture (USDA) and one of its subordinate agencies, the Commodity Credit Corp. (CCC), and abstaining from deciding and dismissing without prejudice the merits of the adversary proceeding. In re Ghent Grain & Feed, Inc., No. 3-85-1792 (D. Minn. Mar. 21, 1986) (order); id. (May 7, 1986)

(order). For reversal Baumann-Furrie argues the district court erred in (1) dismissing its third-party complaint against the USDA and the CCC as barred by the discretionary function exception of the Federal Tort Claims Act (FTCA), 28 U.S.C. §2680(a) and (2) abstaining "in the interest of justice" from deciding the merits of the adversary proceeding pursuant to 28 U.S.C. §1334(c)(1). For the reasons discussed below, we affirm the order of the district court.

This case involves the bankruptcy of a grain elevator, Ghent Grain & Feed, Inc. (Ghent Grain). Ghent Grain, a Minnesota corporation, was a federally licensed grain warehouse facility, Federal Warehouse License Act, 7 U.S.C. §§241-273, and pursuant to the Uniform Grain Storage Agreement, 7 C.F.R.

§1421.5551 et seq., a CCC-approved warehouse facility. Ghent Grain had hired Baumann-Furrie, a licensed public accounting firm, to provide accounting services, including preparation of certain review financial statements required by the USDA and the CCC. In November 1982 Baumann-Furrie submitted a review financial statement for the first six months of 1982 that showed Ghent Grain had a positive balance of more than $253,000. However, in March 1983 Baumann-Furrie submitted a revised review financial statement that showed a deficit of more than $148,000, a net change of more than $400,000. The difference was due to missing or non-existent grain inventories purchased under delayed pricing agreements.

The in August 1983 a "pencil" draft of the review financial statement for the

first six months of 1983 was sent anonymously to the Warehouse Inspection Division Office in Minneapolis, Minnesota. On August 22, 1983, the Warehouse Examiner's Office, Warehouse Division, of the USDA's Agricultural Marketing Service (AMS), conducted a special on-site inspection of Ghent Grain's facilities and discovered the corn inventory was "short" and the soybean inventory had been "overshipped." Also on August 22, 1983, Kellogg Commission, a major grain terminal, cut off Ghent Grain's line of credit.

On August 25, 1983, Ghent Grain was removed from the list of CCC-approved grain warehouse facilities. The next day, the Warehouse Division conducted a second special inspection and suspended Ghent Grain's warehouse license. On

September 9, 1983, the grain elevator closed. On September 12, 1983, there was a third special inspection and a scale ticket audit of warehouse receipts between August 22 and 26, 1983. (The grain in storage was subsequently sold by the trustee, pursuant to an order of the bankruptcy court and the proceeds, over $773,000.00, deposited in a bank account pending distribution to creditors.)

On November 1, 1983, Ghent Grain filed a voluntary Chapter 7 bankruptcy petition. Apellee Gary W. Koch is the trustee. On August 31, 1984, the trustee filed an adversary proceeding against Baumann-Furrie charging Baumann-Furrie with professional malpractice in the preparation of review financial statements for Ghent Grain. The trustee alleged that Baumann-Furrie had

negligently failed to discover overstatements of grain inventories that had been carried as off-site inventories. On November 16, 1984, Baumann-Furrie filed a third-party complaint against the Welshes (the owners of Ghent Grain) and others, and, in June 1985, an amended third-party complaint against the USDA, the CCC, the trustee, and Tri-State Insurance Co. of Minnesota (the surety for the warehouse bond). Baumann-Furrie claimed that the USDA and the CCC were liable for contribution under the Minnesota "Good Samaritan" rule for failure to inspect and verify the off-site grain inventories and failure to audit the review financial statements submitted by Ghent Grain.

On February 19, 1985, some eighty farmers who had sold grain to Ghent Grain

filed a professional malpractice action against Baumann-Furrie in state court. The trustee joined the state case as a party plaintiff. In March 1985 Baumann-Furrie filed a third-party complaint against the same parties who were third-party defendants in the adversary proceeding, except the USDA and the CCC, and removed the case to federal district court, alleging that the USDA and the CCC were necessary and indispensable parties and that there was federal jurisdiction pursuant ot the FTCA, 28 U.S.C. §1346(b).

In July 1985 the UDSA and the CCC filed in bankruptcy court motions to dismiss Baumann-Furrie's third-party complaint. In September 1985, the federal district court quashed Baumann-Furrie's petition for removal and

remanded the farmers' professional malpractice case to state court. (During oral argument of this appeal in December 1986, counsel for the trustee informed the court that the case was scheduled for trial in state court in January 1987). Also in September 1985 the bankruptcy court transferred the adversary proceeding to the district court and, pursuant to 28 U.S.C. § 157(c)(1), issued its report and recommendation that the district court grant and abstain from further consideration of the adversary proceeding. The district court conducted a de novo review and adopted the report and recommendation of the bankruptcy court. The district court dismissed the third-party complaint against the USDA and the CCC as barred by the discretionary function exception of the

FTCA and abstained from considering the merits of the adversary proceeding and dismissed the adversary proceeding without prejudice. In re Ghent Grain & Feed, Inc., No. 3-85-1792 (D. Minn. Mar. 21, 1986) (order); id. (May 7, 1986) (order). This appeal followed.

Discretionary Function Exception

Baumann-Furrie argues the district court erred in holding its third-party complaint against the USDA and the CCC was barred by the discretionary function exception of the FTCA, 28 U.S.C. §2680(a). Baumann-Furrie argues that federal warehouse licensing regulations, 7 C.F.R. §102.6(c) (now in 7 C.F.R. §736.6(c) (1986)), affirmatively required the UDSA to inspect and verify Ghent Grain's inventories and to audit its review financial statements. (Under 7

C.F.R. §1421.555, federally licensed warehouses are excepted from applicable CCC warehouse standards.) Baumann-Furrie emphasizes that because it prepared only review, not audited, financial statements for Ghent Grain, its accountants were not required by established accounting principles to independently verify Ghent Grain's inventories and did not do so. Baumann-Furrie argues that if the USDA and the CCC had in fact properly audited Ghent Grain's review financial statements as required by federal regulations, Ghent Grain's true financial condition would have been discovered and the losses prevented or reduced. Baumann-Furrie acknowledges that the USDA's decision to require verification of review financial statements by audit is a regulatory action protected by the discretionary

function exception, but argues that the discretionary function exception does not apply to actual performance of the required audit, citing Aslakson v. United States, 790 F.2d 688, 692-94 (8th Cir. 1986).

Although we accept Baumann-Furrie's distinction between regulatory decision-making and actual performance in compliance with regulations, we cannot agree with Baumann-Furrie's reading of 7 C.F.R. §102.6(c) to affirmatively require the USDA to audit review financial statements submitted by federally licensed warehouses. Under 7 C.F.R. §102.6(c) the required financial statements are to be "audited by an independent certified public accountant .... [or,] [a]lternatively, financial statements audited or reviewed by an

independent public accountant will be accepted with the understanding that the warehouseman will be subject to an additional on-site examination by the Secretary [of the USDA] and to an audit by the Secretary." The regulation does not mandate audits of review financial statements by the USDA; it provides only that financial statements reviewed by independent public accountants are acceptable but, unlike financial statements audited by independent certified public accountants, "will be subject" to additional verification by on-site examination and audit by the USDA.

In addition, the USDA's decision to make certain financial statements "subject" to additional verification, but not to require on-site examination or

audits, is precisely the kind of agency action protected by the discretionary function exception of the FTCA. See United States v. Varig Airlines, 467 U.S. 797, 813-14 (1984). In that case, the Court held that the Federal Aviation Administration's decision to review manufacturer compliance with safety standards by "spot-checking" was protected by the discretionary function exception. Id. at 819-20. Here, the USDA has decided not to inspect and audit every federally licensed warehouse and instead has determined that a program of placing the primary responsibility for maintaining "complete, accurate and current financial records" upon the warehouseman and making review financial statements subject to additional examination and auditing best accomodates

the goal of financial responsibility and the reality of limited agency resources. The possibility of additional examination and auditing by the USDA is comparable to the FAA's "spot-check" system. "When an agency determines the extent to which it will supervise the safety procedures [or, in this case, the financial records] of private individuals, it is exercising discretionary regulatory authority of the most basic kind." Id.

Abstention

Baumann-Furrie next argues the district court erred in abstaining from deciding the merits of the adversary proceeding. Although the district court cited 28 U.S.C. §1334(c)(1), Baumann-Furrie argues the reasons stated by the district court in support of its abstention decision are those set forth

in 28 U.S.C. §1334(c)(2), a statutory provision that was not applicable to adversary proceedings pending on July 10, 1984. Baumann-Furrie also argues the district court abused its discretion in abstaining under 28 U.S.C. §1334(c)(1). The trustee argues that this court lacks appellate jurisdiction to review the abstention decision because the prohibition against appellate review in 28 U.S.C. §1334(c)(2) applies to abstention decisions under 28 U.S.C. §1334(c)(1) as well. (The court of appeals denied the trustee's motion to dismiss the appeal without prejudice on July 11, 1986.)

We hold that we have appellate jurisdiction to review the district court's decision to abstain. The prohibition against review of abstention

decisions was contained in 28 U.S.C. §1471(d), which was enacted as part of the Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, §241(a), 92 Stat. 2668, and provided:

> Subsection (b) or (c) of this section does not prevent a district court or bankruptcy court, in the interest of justice, from abstaining from hearing a particular proceeding arising under title 11 or arising in or related to a case under title 11. Such abstention, or a decision not to abstain, is not reviewable by appeal or otherwise.

Before the Supreme Court held the broad grant of jurisdiction to the bankruptcy court in §1471 was unconstitutional in Northern Pipeline Construction Co. v. Marathon Pipe Line Co., 458 U.S. 50 (1982) (Northern Pipeline), in June 1982, this court had held that abstention decisions were not subject to appellate review pursuant to 28 U.S.C. §1471(d). See In re Med General, Inc., 672 F.2d

716, 718-20 (8th Cir. 1982); accord In re Covey, 650 F.2d 877, 880 (7th Cir. 1981).

However, following Northern Pipeline, §1471(d) was repealed by the Bankruptcy Amendments and Federal Judgeship Act of 1984 (1984 Amendments), Pub. L. No. 98-353, §113, 98 Stat. 343. Section 101(a) of the 1984 Amendments added subsection (c) to 28 U.S.C. §1334. title 28 U.S.C. §1334(c) provides:

> (1) Nothing in this section prevents a district court in the interest of justice, or in the interest of comity with State courts or respect for State law, from abstaining from hearing a particular proceeding arising under title 11 or arising in or related to a case under title 11.
>
> (2) Upon timely motion of a party in a proceeding based upon a State law claim or State law cause of action, related to a case under title 11 but not arising under title 11 or arising in a case under title 11, with respect to which an action could not have been commenced in a court of the United States absent

> jurisdiction under this section, the district court shall abstain from hearing such proceeding if an action is commenced, and can be timely adjudicated, in a State forum of appropriate jurisdiction. Any decision to abstain made under this subsection is not reviewable by appeal or otherwise. This subsection shall not be construed to limit the applicability of the stay provided for by section 362 of title 11, United States Code, as such section applies to an action affecting the property of the estate in bankruptcy.

Under subsection (c)(1), abstention is discretionary; however, under subsection (c)(2), abstention is mandatory. See In re Bobroff, 766 F.2d 797, 802 n.3 (3d Cir. 1985); In re White Motor Credit, 761 F.2d 270, 272 (6th Cir. 1985).

The §1471(d) prohibition against appellate review of abstention decisions is now contained in §1334(c)(2). The prohibition against appellate review of decisions to abstain in subsection (c)(2) arguably also applies to subsection

(c)(1). See In re Aaronics Equipment Rentals & Sales, Inc., 14 Collier Bankr. Cases 2d (MB) 332, 335-36 (Bankr. M.D. La. 1985). However, regardless of the scope of subsection (c)(2), that subsection does not apply to cases which were pending when the 1984 Amendments were enacted on July 10, 1984. 1984 Amendments, Pub. L. No. 98-353, §122(b), 98 Stat. 346; see In re American Pouch Foods, Inc., 769 F.2d 1190, 1198 (7th Cir. 1985), cert. denied, 106 S. Ct. 1459 (1986); In re Bobroff, 766 F.2d at 802 n.3. Because this case was pending on July 10, 1984, §1334(c)(2), including the prohibition against appellate review of abstention decisions, does not apply.

On the merits we find no abuse of discretion in the district court's decision to abstain. As noted by the

district court, a state action involving the same state law issues presented in the adversary proceeding is now pending in state court.

Accordingly, we affirm the order of the district court.

A true copy.

Attest:

CLERK, U.S. COURT OF APPEALS,
EIGHTH CIRCUIT.

UNITED STATED DISTRICT COURT
DISTRICT OF MINNESOTA
THIRD DIVISION

---

Civil File No. 3-85-1792

---

In re: Ghent Grain and Feed, Inc.,

Debtor,

Gary W. Koch, Trustee,

Plaintiff,

v.

Baumann-Furrie and Company,

Defendant and
Third-Party Plaintiff,

v.

James Welsh, et al.,

Third-Party Defendants.

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ORDER

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The court, by its own initiative, finds that an amendment to its Order dated March 21, 1986 is appropriate under

Rule 60(a) of the Federal Rules of Civil Procedure to correct an omission in that Order and clarify the disposition of this matter. Accordingly, IT IS ORDERED that:

The Order of this court dated March 21, 1986 is amended to read as follows:

1. The motion to dismiss for failure to state a claim upon which relief can be granted of Third-Party Defendants, Commodity Credit Corporation and United States Department of Agriculture, is granted and the third-party claims against these third-party defendants are hereby dismissed with prejudice.

2. Pursuant to 28 U.S.C. §1334(c)(1), the court abstains from considering the merits of this adversary

proceeding and this matter is hereby dismissed without prejudice.

Dated: May 7, 1986.

/s/ Paul A. Magnuson
United States District
Judge

UNITED STATED DISTRICT COURT
DISTRICT OF MINNESOTA
THIRD DIVISION

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Civil File No. 3-85-1792

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In re: Ghent Grain and Feed, Inc.,

Debtor,

Gary W. Koch, Trustee,

Plaintiff,

v.

Baumann-Furrie and Company,

Defendant and
Third-Party Plaintiff,

v.

James Welsh, et al.,

Third-Party Defendants.

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ORDER

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This matter comes before the court on Objections filed by defendant and third-party plaintiff, Baumann-Furrie and

Company, to the Recommendation of the Bankruptcy Court dated September 26, 1985. The Bankruptcy Court, in entertaining a motion to dismiss of third-party defendants Commodity Credit Corporation and United States Department of Agriculture, issued its Recommendation Regarding Disposition pursuant to 28 U.S.C. §157(c)(1). The Bankruptcy Court recommended that the District Court grant the motion to dismiss of third-party defendants Community [sic.] Credit Corporation and the United States Department of Agriculture. In addition, the Bankruptcy Court recommended that the District Court abstain from further consideration on the entire proceeding. Defendant and third-party plaintiff, Baumann-Furrie and Company, objects to such Recommendation.

When a party files objections to the Recommendation of the Bankruptcy Court, the court must conduct a de novo review of those portions of the Recommendation to which the party specifically objects. 28 U.S.C. §157(c)(1). Based upon an independent review of the files and records in this case, and the memoranda of counsel, and after conducting a de novo review of those portions of the Recommendation Regarding Disposition of the Bankruptcy Court dated September 26, 1985.

In so ruling, the court rejects Baumann-Furrie's contention that the Bankruptcy Court erred in determining that the claims asserted against Commodity Credit Corporation and United States Department of Agriculture were precluded under the discretionary

function exception of the Federal Tort Claims Act, 28 U.S.C. §2680(a). The alleged tortious conduct on the part of the federal agencies arises out of the performance of their regulatory and monitoring functions with respect to the bankrupt, Ghent Grain and Feed, Inc. Such functions concern the agencies' decision as to the extent they will supervise the warehouse's duties to provide accurate financial statements and meet the minimum net asset requirements. Under such circumstances, the agencies' alleged negligence in failing to discover the warehouse's noncompliance is subject to the discretionary function exception under United States v. S. A. Empresa de Viacoa Aerea Rio Grandense (Varig Airlines), ___ U.S. ___, 104 S. Ct. 2755 (1984).

In Varig Airlines, the Supreme Court held that the discretionary function exception barred a tort action against the government based on the Federal Aviation Administration's (FAA) adoption and implementation of a "spot-checking" program to ensure that aircraft complied with FAA safety regulations. The Court found that the FAA's development of a system for enforcing compliance with safety standards was "plainly discretionary". Id., 104 S. Ct. at 2768. The court further held that the acts of the FAA employees in conducting spot-checks were also protected as discretionary activity. Id.

Like the FAA in Varig Airlines, the federal agencies in this action placed primary responsibility on the warehouses, requiring the warehouses to provide

accurate financial statements and meet the minimum net asset requirements. The agencies monitored the warehouse's compliance with the regulations by providing for periodic audits and on-site examinations. Under the rule announced in Varig Airlines, the agencies' actions in this respect are protected by the discretionary function exception of 28 U.S.C. §2860(a). The third-party action against Commodity Credit Corporation and the United States Department of Agriculture is therefore dismissed.[1]

The court also concludes that abstention under 28 U.S.C. §1334(c)(1)[2]

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[1] The court does not specifically address Baumann-Furrie's additional claim for conversion, but adopts the determination of the Bankruptcy Court on that issue.

[2] Section 1334(c)(1) provides, in pertinent part:

"Nothing in this section prevents a

is appropriate under the circumstances. There is currently pending a state court action involving substantially similar issues. That action will be timely adjudicated before a court familiary with the case and the legal issues presented, legal issues wholly involving state law. Further federal court involvement would result in a duplicative and uneconomical use of scarce judicial resources. In the interests of justice, abstention is thus warranted in this case.

In concluding, the court notes that the parties have filed various motions unrelated to the Recommendation of the Bankruptcy Court. Given the court's

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district court in the interests of justice, or in the interests of comity with State courts or respect for State law, from abstaining from hearing a particular proceeding."

28 U.S.C. §1334(c)(1).

determination in this matter, those motions are not appropriately before this court and the court declines ruling on such motions.[3]

Accordingly, IT IS ORDERED that:

1. The motion to dismiss for failure to state a claim upon which relief can be granted of Third-Party Defendants, Commodity Credit Corporation and United States Department of Agriculture, is granted and the third-party claims against these third-party defendants are hereby dismissed with prejudice.

2. Pursuant to 28 U.S.C. §1334(c)(1), the court abstains from

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[3] Such motions include: (1) Baumann-Furrie's Motion for Stay of Review; (2) Baumann-Furrie's Motion for Leave to Conduct Further Discovery; and (3) Trustee's Motion for Dismissal Without Prejudice.

considering the merits of this adversary proceeding.

Dated: March 21, 1986.

/s/ Paul A. Magnuson
United States District
Judge